European Union: Constraints vs. Opportunities

By

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ABSTRACT

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During the early 1980s, Europe suffered from slow economic growth. As a result of this stagnant growth pattern, the European Union created new economic policies and reforms, which eliminated tariffs and barriers among European member states, and set new rules for competition law. The European Union eliminated most regional trade barriers but was not able to achieve the same success with inter-regional barriers. While many supporters of European Union applauded the reform, several American companies claimed that Europe’s new economic regulations pose disadvantages for American companies in form of a fortress. Constraints are the outcomes of different institutional regulations and protectionism. This study will present the arguments from both sides of the Atlantic and conclude that the opportunities created by the European Union outweigh the constraints for some non-European companies.

ACKNOWLEDGMENTS

As a teenager I witnessed the fall of the Berlin Wall and how Europe changed during the era of creating a European Union. Since 1989, I have striven to learn more about globalization and international business. While working as a business consultant in France, I became a keen observer of transatlantic disputes, which sparked my interest in returning to the university and study trade relations between Europe and the United States.

I would like to thank my thesis committee, Professor Margaret Schomaker, Professor Tailan Chi and Professor Robert Rodriguez for their advice and patience. Also, I would like to give special thanks to Clarissa Jackson, the KU Center for Economic Education, my family and friends for their support.

Nguvi Kahiha
"Inspired by globalization" 2007

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PART I

1.1. Introduction

The advancement of technology, similarity of markets, cheaper communication and transportation opportunities, and declining trade barriers have encouraged companies to expand business abroad with hopes of increasing their global market share.[1] In the post-World War II era, globalization is characterized by the evolution of trading blocks and regional integrated markets. Within each integrated market, nations open up their individual markets and are able to establish interdependence among member states. The newly formed integrated market system allows economic growth through trade liberalization and competition. Today, there are more than 25 different economic regions, with three integrated markets dominating global trade: the North American Free Trade Agreement (NAFTA) between the United States, Canada and Mexico, Japan/Asia, and the European Union (EU).[2] These dominating entities are similar in terms of consistent economic growth, infrastructure with uniform demand and protectionist pressure.[3] The European Union is considered the most integrated region because it has established an economic union, as well as a single market, single currency and institutions that represent all member states on trade policy issues.[4]

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[1] Porter, 1986 pg. 2
[2] Japan/ Asia is not an official integrated union
[3] Rugman et al, 2004 pg. 4
[4] European Commission, 2002 pg. 1

If these newly integrated markets follow a free market system that sparks economic growth opportunities, could multinational enterprises (MNE) experience similar growth in all regions? Some scholars would argue that they could not.

A new school of thought in international business, led by Alan Rugman, argues that globalization is a myth, because most business activities are not conducted in one single global market, but instead by companies within each of these regional blocks.[5] Based upon empirical research, this new school of thought claims that most multinational enterprises are not global companies but rather semi-global or regional companies which gain the majority of sales from their regional home markets.[6] Rugman argues that only companies with significant market share in all three dominant regions can be considered "true" global companies. Rugman claims that multinational enterprises face constraints in potential host regions in the form of non-tariff barriers.[7] An important reason is *the liability of foreignness*. The liability of foreignness can be defined as a competitive disadvantage to foreign firms in a host market, because local companies have more knowledge about their economy and culture. "The liability of intra-regional expansion appears to be much lower than the liability of inter-regional expansion," therefore, they focus on doing business in their home region.[8] Rugman's view adds to the argument that American companies face considerable impediments to trade.

[5] Rugman et al, 2001 pg. 1
[6] Rugman et al, 2006 pg. 2
[7] Rugman, 1998 pg. 6
[8] Rugman et al, 2006 pg. 3

Existing literature explains how the creation of the European Union has affected transatlantic relations. Prior to the creation of the European Union, American companies were concerned that the new Europe would create a European fortress and keep non-European goods out of the region or at least make it more difficult for them to enter.[9] Even 15 years later, many U.S. companies argue that there is still a European fortress in the form of protectionism, and strict regulations. On the other hand, advocates of the European Union explain that the European Union's economic policies create opportunities for American companies in Europe. Both sides of the Atlantic have legitimate arguments about the benefits and barriers that the European Union creates. This raises an important theoretical question: What opportunities does the European Union create for American companies?

1.2. Structure of Study

First, this study explains the economic characteristics of the European Union. It summarizes the evolution of the market, as well as evaluating the Union's objectives of creating a more dynamic market with competitive companies. Second, the study presents complaints from American companies regarding the economic constraints arising from the establishment of a single European market. These series of constraints contribute to a phenomenon often referred as the "European fortress". Complaints from American companies include European protectionism and strict regulations which impede American entry into the market. Third, this study examines

[9] Lynn, 1992 pg. 29

Europe’s response to the accusation of creating a European fortress. European Union advocates argue that the European Union encourages transatlantic ties with the American market. While there are new constraints created by implementing the European Union, evidence supports the argument that the European Union is striving for stronger relationships with the American market. The final parts of this study propose possible opportunities for American companies in the European Union.

1.3. Significance of study

Regional market integration theory focuses mainly on the benefits to local companies and the constraints on foreign companies. This research, however, presents opportunities for multinational companies from non-member countries who seek to penetrate the European Union’s market. It outlines some possible opportunities that are outcomes of the economic reforms. Multinational companies can then apply strategies related to firm-specific advantages to exploit these opportunities. This study also invites further studies on how to exploit trade opportunities of other regional integrated markets.

1.4. Hypothesis

This paper discusses the characteristics of the European Union in a business context. International business, free trade and institutional theory explain that the European Union provides the composition of regulations and policies that will: (a) indirectly set new constraints for U.S. firms *entering* the market; and (b) facilitate individual U.S. firms to operate *within* the European Union. In other words, the European institutional framework eliminates internal trade barriers and creates strict regulations to provide security to the European environment, citizens and market. By doing so, it raises impediments to trade to non-European countries. However, despite these constraints, some American companies will find lucrative opportunities by overcoming the constraints.

PART II

2.1. The European Union: Brief History

The European Union has accomplished market integration in a relatively short time and to an unprecedented extent. Following the theory of regional economic integration, which holds that countries within a particular region can jointly gain economically by entering into agreements to reduce or eliminate tariff and non-tariff barriers, Europe went from a customs union to an economic union in less than 50 years. [10] In theory, within the European Union, European companies can take advantages of the free flow of goods and services, labor and capital. In addition, the establishment of a single currency, the Euro, encourages foreign direct investment, because it increases transparency, permits comparison of member countries, and reduces risk to investors, as a stable currency. To better understand the evolution of the European Union, this section will explain the reason for creating a single market and the possible economic effects to European companies.

2.2. The European Union: From Eurosclerosis to European Optimism

Since the end of World War II, several European states keenly sought a strategy to reduce the risk of further military conflicts and provide economic development to revive the destroyed economies. In 1951, six European countries, -Germany (West), Italy, Belgium, Luxemburg, the Netherlands and France- signed the

[10] Hill, 2004 pp. 272-273

Treaty of Paris, creating the European Coal-Steal Community and setting in motion the process that would lead to the European Economic Community, the forerunner of the European Union. The European Coal and Steel Community's objective was to wed the war prone countries that hosted two wars in a thirty year time span.

In 1957, the Treaty of Rome established an economic integration in the European Economic Community by eliminating all barriers between member states. It set forth a common external trade policy through intergovernmental cooperation.[11] The transition to a common market took several years to implement, but success was evident from the start. Following the signing of the Treaty of Rome, the six European Economic Community states experienced a significant increase in economic growth, which notably can be accounted to the increase of trade among them.[12] The European Union also designed several policies that would protect certain important European industries, such as the agricultural industry.[13]

The intra-regional economic boost encouraged many neighboring countries to apply for membership to the European Economic Community. Since the creation of the European Economic Community in the late 1950s, more than 20 other European countries have applied for membership, with most applications granted. In 1973, the United Kingdom, Ireland and Denmark entered the European alliance. Over the following thirteen years, three southern European countries (Portugal, Greece and Spain) joined the community. In 1996, Austria, Finland and Sweden broke out of a

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[11] Van Oudenaren, 2000 pg. 8
[12] Dinan, 2005 pp. 47-48
[13] See Case study in Part IV

free trade area alliance (European Free Trade Association) to enlarge the area of economic integration to 15 states. However, the largest influx happened in 2004 when ten eastern European countries were able to claim the European Union flag. The latest enlargement took place in 2007, adding two more nations to the market with three more nations on the waiting list.

Table 1: European Enlargement

Year	Countries	No. of countries	Population as of 2005 in millions
1957	Germany, France, Belgium, Netherlands, Italy, Luxemburg	6	228.8
1973	Denmark, Ireland, United Kingdom	3	69.4
1981	Greece	1	11.1
1986	Spain, Portugal	2	48.7
1995	Austria, Finland, Sweden	3	22.4
2004	Cyprus, Estonia, Czech Republic, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia	10	73.6
2007	Bulgaria, Rumania	2	29.5
Future Enlarge ments:	Turkey, Croatia, Republic of Macedonia,	3	78.0
	Prospected Size	**30**	**561.5**
Data source: http://europa.eu/abc/index_en.htm			

The continuous overhaul of economic policies in the European Union has been greatly anticipated and supported by Europeans amid economic stagnation in the early-1980s.[14] The European member states faced several economic shocks that led to economic problems.[15] Europe experienced a high rate of job loss and economic stagnation.[16] European companies lacked competitiveness, because of the inability to apply free trade among the member states. Due to small markets and different market regulations, companies were not able to achieve economies of scale. The trade flow

[14] Hunter, 1991
[15] Dinan, 2005 pp. 69-74
[16] Hunter, 1991

of goods and services was slowed down by unnecessary delays on borders between countries. Similar inefficiencies were evident in cross-border financial services, the transfer of knowledge, technology and labor. Some explanations for the negative economic trends were high labor costs due to excessive social protection, high labor concentration in slow growth industries and inefficient institutional regulations.[17] This phenomenon in Europe of poor job creation and lack of competitiveness within the business sector was frequently referred to as "Eurosclerosis".[18] As a result, European regulators refined the European Economic Community to provide economic reforms that would allow "economic dynamism allied to social protection."[19]

The Single European Act intended to allow the European Economic Community to create a competitive market with more competitive European companies. In 1984, the European Community decided to "re-launch" Europe by creating a single internal market.[20] Lord Cockfield, an economist from the United Kingdom, who served for several years under the Thatcher administration, was one of the chief architects of the single market. His key principle for a successful and functional single market was an open market, without barriers or access to competition. In an interview, Cockfield explained his strategic decisions, "Once you get the frontier down and you allow trade to flow freely, those sheer pressures of trade will eliminate many of the barriers. You release the competitive force... Getting

[17] Navarro, 1998
[18] Alogoskoufis, 2007; Flingstein et al, 1996 pg. 10
[19] Mandelson, 2005
[20] Guttman, 1992 pg. 13

rid of the barriers and the forces of competition will perfect the market."[21] The Single European Act was signed in 1986 and refined the European Economic Community's mission to unify the European market. The objectives were to complete the reform by the end of 1992.[22]

The single market of the European Union came into effect in 1987 with a target date of December 31, 1992 for full implementation, and was based upon eliminating barriers of goods and services, labor and capital. This would allow goods, services, money and people to move freely across the member states. Most time-consuming and costly administrative procedures were eliminated. Labor could relocate to regions where skilled labor was in demand and tourism became easier and more convenient. In order to institute technical regulations and standards, the European Union employed uniform set of standards that established "essential requirements" for the production of goods. At the same time, member states entered into "Mutual Recognition Agreements", which required all countries to accept goods and services from other member countries when meeting the necessary safety, health and environmental requirements.[23] This reduced research and development costs dramatically. The testing and quality control for a product had to pass only one standard requirement. For example, the automobile industry had to conduct only one crash test. The harmonization of laws and practices allowed lawyers, accountants and doctors to work throughout the European Union without obtaining new licenses for

[21] Guttman, 1992 pg. 14
[22] Moravcsik, 1991 pg. 24
[23] Oudenaren, 2000 pg.106; Flingstein et al, 1996 pg. 18

each new country. The European Union implemented high standards and strict rules to satisfy the demand for consumer and environmental protection.

One core aim of the European Union was to allow healthy competition within the market. The European Commission is the institutional apparatus of the European Union that monitors competition policies and ensures that no business monopolizes the market.[24] Similar to the European Central Bank, the Commission is an independent body that represents the Union, not individual states. The European Commission deregulated several industries and demanded that governments privatize state-owned enterprises. Governments lost partial or full control over state-owned enterprises and national protected companies in certain industries. These companies had a monopolistic status in the domestic market and now have to compete with new companies. The increased competition resulted in declining prices and profit margins.[25] To offset the lower profit margins, companies applied new strategies to become more efficient in production. As a result, the European Union provides the foundation of a stronger dynamic market with competitive companies and economic growth potential.

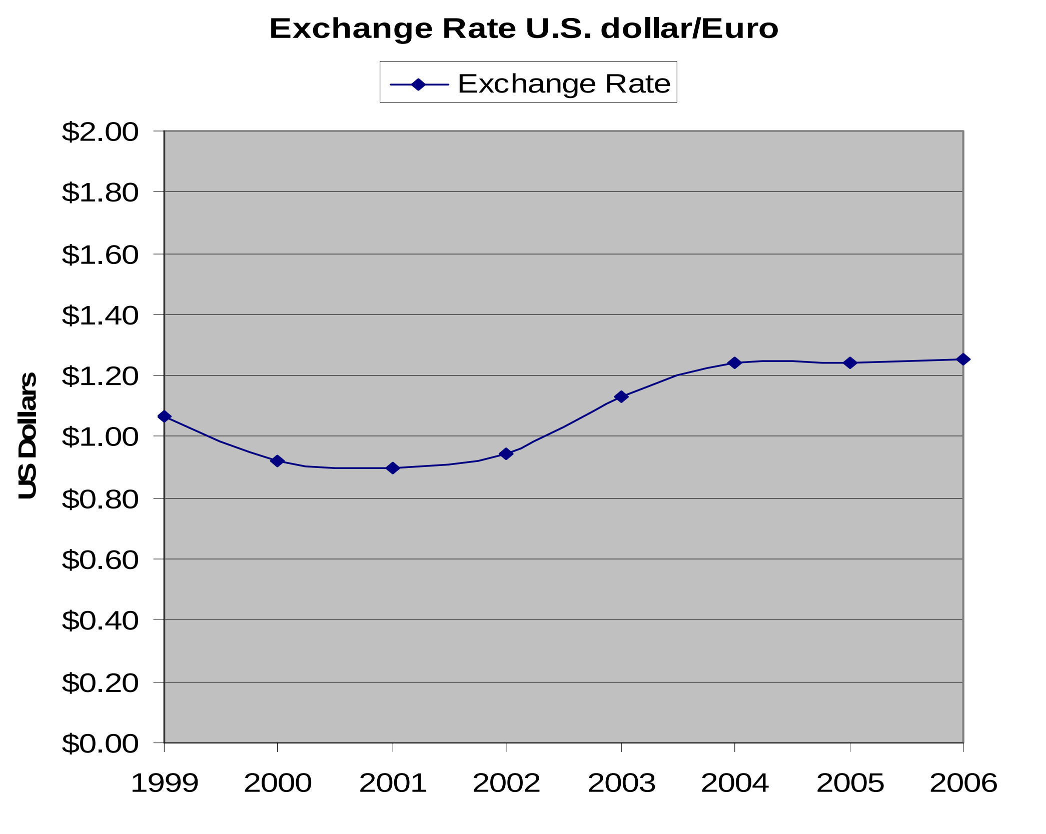
Additional reforms and reform revisions took place after 1992. The creation of the European Monetary Union ushered Europe into a new phase of economic integration. The adoption of a single currency, common monetary fiscal policy and harmonized tax policy were all characteristics of an economic union.[26] There was

[24] Hill, 2004 pg. 281
[25] Ilzkovitz et al, 2007 pg. 28
[26] Hill, 2004 pg. 275

significant economic and political reasoning behind the establishing of the Euro. It was aligned with Europe’s mission to eliminate non-tariff trade barriers that were created by differing exchange rates and currency fluctuation and facilitated intra-European trade. Scholars in international business show that countries with common currencies and membership in the same economic market have an increased likelihood of internal trade (over 300 %!).[27] A single currency would eliminate exchange costs thus would save money from international transactions. The internal effects of strengthening the European integration also had external effects. The creation of the Euro strengthened Europe’s position in world affairs, politically and economically, with the Euro competing with the US dollar.[28]

[27] Ghemawat, 2001 pg. 138
[28] Oudenaren, 2000 pg. 169; Rifkin, 2004 pg. 64

Graph 1: Exchange Rate U.S. dollar/Euro



Statistical Data from European Central Bank
http://www.ecb.int/stats/html/index.en.html

The introduction of the Euro faced concerns within the market. Member states were skeptical about its economic effects on the market and the loss of monetary sovereignty. Several countries opted not to join the Euro zone. Only 13 of 27 countries agreed to change currency. Germany and France lobbied hard for its implementation and introduced several policies to facilitate the introduction of the Euro. In the 1980's the European Union established the European Monetary System to lock all European currencies against the ECU (forerunner of the Euro), which provided monetary stability.[29] The Maastricht Treaty provided guidelines for the Euro zone. States had to meet certain requirements to be eligible to join the Euro zone. Countries had to control inflation to guarantee price stability and national exchange rates. Furthermore, they had to keep the national deficit under three percent and had to provide competitive, long term interest rates.[30] For future assurance, the countries signed the stability and growth pact, which would punish countries that fell below the requirements.

Map 1: Eurozone- 2008

Source: http://frazer.rice.edu/~erkan/blog/archives/EurozoneMap.gif

[29] Oudenaren, 2000 pp. 174-175
[30] Oudenaren, 2000 pg. 186

Since the last accession of Romania and Bulgaria in 2007, the European Union has become a 27 state strong union with three more countries (Turkey, Croatia and Macedonia) on the waiting list. The population is reaching nearly half a billion people communicating in 23 official languages.[31] Today, 15 years after the implementation of the European Union, Europe was able to battle its malady of "Eurosclerosis". In 2006, the European job market increased by about 3.5 million which was twice as much than the job creation prior the 1992 integration.[32] The European Union member states were also able to reduce their deficit and participated in expanding European economic growth. Intra-Eurozone data suggests that the Euro had a positive effect on trade flow among these countries.[33] In addition, foreign direct investment among the member states increased and had a significant impact on gross domestic product of the new member states. These results are clearly a sign that economic reform in Europe and future development seems promising. A country portfolio analysis concludes that enlarging Europe by inducting Turkey and Norway, the European Union would experience additional economic growth and stability.[34]

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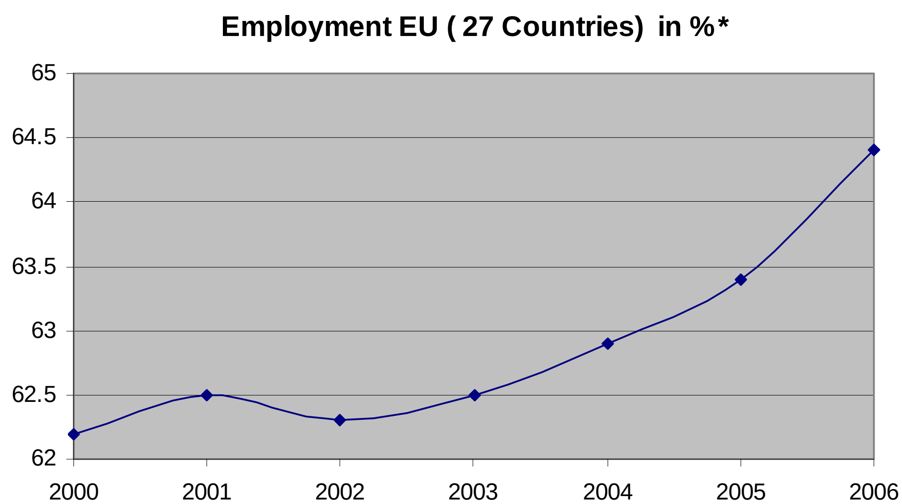
[31] CIA, 2007
[32] European Commission, 2006
[33] European Commission, 2007
[34] Goldberg, 2000

Graph 2: Employment Rate of EU (27 Countries)



* The employment rate is calculated by dividing the number of persons aged 15 to 64 in employment by the total population of the same age group. The indicator is based on the EU Labour Force Survey. The survey covers the entire population living in private households and excludes those in collective households such as boarding houses, halls of residence and hospitals. Employed population consists of those persons who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent.

Data Source: Eurostat

http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em011

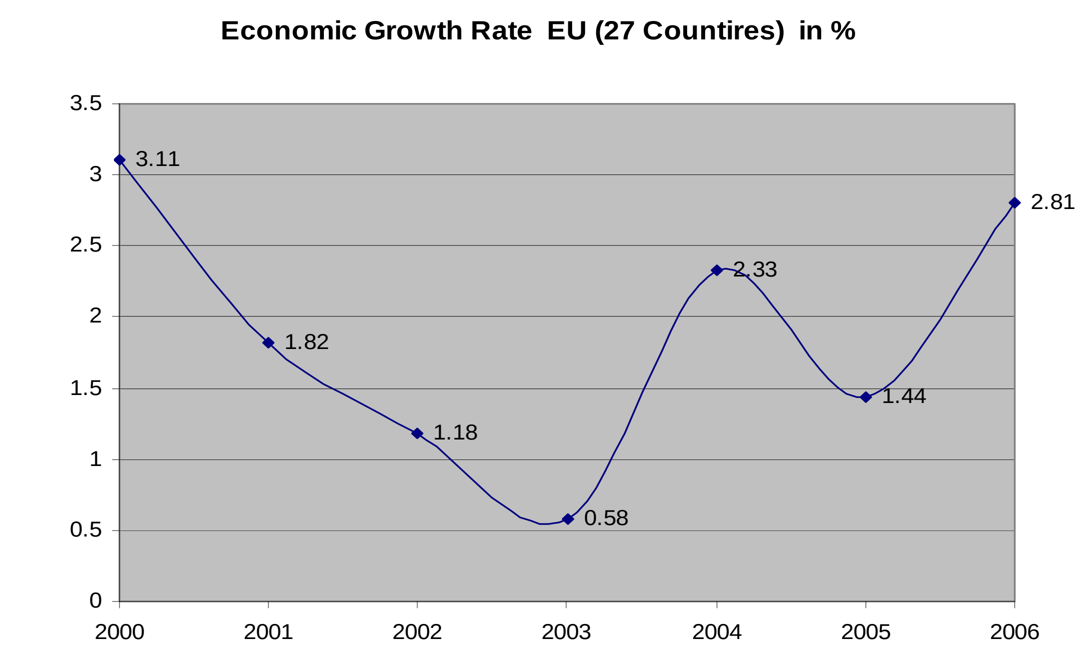
A report by the European Commission, titled "Steps towards a deeper economic integration," has analyzed in detail European economic performance. According to the report, trade liberalization and market openness allowed companies to compete for market share. As a result, competition changed market conditions by creating new market leaders and reducing profit margins by 3.9 % in the 1990s.[35] The report suggests that European companies have implemented more competitive and cost-efficient strategies to offset the reduction of profit margins and increased competition for market share.

[35] European Commission, 2007 pg. 42

> "Evidence shows that between 1987 and 2000, firms in the Internal Market have expanded in size and increased their presence beyond national borders, often via cross-border mergers and acquisitions involving firms from different Member States and from outside the EU. Whereas in 1987, EU leading firms were on average active in three countries, this number increased to an average of five countries…. The sharper competition in the Internal Market can also contribute to the elimination or take-over of the least efficient firms, leaving only fewer producers (bigger and more efficient) in the market. This should result in an increase in production concentration at the EU level. "[36]

It can be concluded from this passage of the report that the economic policies of the European Union created more competitive companies, and a more dynamic market.

Graph 3: Growth Rate: Gross Domestic Product of EU (27 Countries)



Data Source: Eurostat:
http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=sdi_ed&root=sdi_ed/sdi_ed/sdi_ed1000

[36] European Commission, 2007 pg. 43

2.3. Summary

European Union institutions reduced internal trade barriers and created a dynamic European market with more competitive European companies. The European Union has increased its economic power in the world market by creating the most integrated regional economic region in the world. Intraregional trade flow has increased, and all member states have benefited from the membership and enlargement. Economic dynamism can be achieved by allowing companies to apply an economy of scale in the extended market. The elimination of barriers allows supply chain operations to run more effective, and transfer of knowledge and technology becomes faster and efficient. Free flow of labor and investment lets companies to pull skilled labor from different regions or move operations to areas where factor endowments are abundant.

PART III

3.1. The European Fortress

The flip side to the elimination of trade barriers within the European Unions is the creation of constraints to non-European companies. Both sides of the Atlantic present different perspectives on the European economic integration. The U.S. government and some of its companies claim that the new policies create impediments to trade, which make it more complicated for U.S. businesses to compete equally with European companies in Europe. The constraints that are created by implementing stricter safety, consumer and environment standards as well as the protection of certain industries, are frequently referred to as a *fortress*. These new standards and regulations are more costly to meet for many companies. This part of the study will give a theoretical explanation about the impediments of trade. Trade disputes and transatlantic issues will explain that European protectionism and Europe's stricter regulations are the cause of impediments.

3.2. Theoretical explanations of transatlantic trade

A new school of thought in international business has surfaced which argues most multinational enterprises are not actually global companies but rather regional or semi-global, because most of their revenues are generated in the home region.[37] They are focusing activities within the expanded and deepened home market instead

[37] Ghemawat 2003; Rugman et al, 2001, 2003, 2004

of non-regional markets. This theory is based on cross-regional trade flows in the three dominant economic regions where most of the multinational enterprises are located and gain most of their revenues in their home region.[38] Data shows that 60 percent of European exports are within its region.[39] While the US exports 20 percent of its total exports to the EU,[40] this is far less than export to its NAFTA partners. According to the U.S. Census Bureau, the U.S. has a consistent trade deficit with Europe.[41] The U.S. showed its discontent with EU economic policy-making by filing several disputes with the World Trade Organization.

Alan Rugman, one of the promoters of this new regional trade theory, explains the reasons of this cross-regional trade trend, which are based on the effects of non-tariff barrier constraints:

> "One reason for this is the presence of non-tariff barriers to trade and investment in these regions. These are designed to limit access to internal markets or to give preferential access to certain partners in return for reciprocal advantages. Such barriers include rules of origin, discriminatory health and safety codes, exemptions from trade agreements claimed for certain sectors (such as culture, education, health), poorly administered anti-dumping and countervailing duty laws, and so on."[42]

The theory explains that the lack of cross-market performance is due to the external threats of competition, protectionism, and local preferences and the inability

[38] Rugman et al, 1998, 2002, 2004
[39] Rugman et al, 2001 pg. 6
[40] Rugman et al, 2001 pg. 6
[41] U.S. Census, 2007
[42] Rugman et al, 1998

to apply internal strengths in the host region.[43] Most multinational companies focus on products, processes or business models to try to create firm-specific advantages or comparative advantages. In order to increase their market share, companies adopt or modify their business model to the local market to achieve economies of scale.[44] However, there are external threats in the host market that hinder multinational companies' ability to penetrate new markets effectively. For example, products that meet consumer needs or preferences in one market might not have the same success in another market. In this case, it is important to understand the consumers' tastes and preferences. Some markets perform slower; thus, economic growth might not be as easy to achieve as in a fast growing market. There is also the threat of competition and protection of certain industries. Since most multinational companies produce goods that require high capital investments, penetrating a market that does not guarantee enough return on investments, creates constraints.[45] These investments include funds to cover costs arising from differences in standards.

Another explanation of external threats on cross-regional trade is the impact of distance.[46] Pankaj Ghemawat, Professor at the Harvard Business School, designed a framework that measures the attractiveness of foreign markets by examining four distance dimensions of a market. Distance, in this context, represents differences or similarities between markets. This framework states that there is a distance between trade regions with regards to culture, economy and governance, which determines

[43] Rugman et al, 2004 pg. 6
[44] Ghemawat, 2003 pg. 1
[45] Rugman et al, 2004 pg. 4
[46] Rugman et al, 2006 pg 3

how attractive trade is among regions.[47] In other words, if the distance between two markets' cultures, economies, or governments is large, the combination is less attractive for doing business. There are certain distances that existed before the creation of the European Union, such as language barriers and geographic distance. These still exist.

The establishment of European institutions affects distances as well. Ghemawat suggests that regulations and policies of individual governments are the source of most common trade barriers.[48] He goes on to argue that regulatory bodies protect their markets if foreign competition threatens important industries or companies to the region. The European Union eliminated all trade barriers within the market and functioned now as a single market. Hence it can be assumed that the European institutions, considered as a single regulatory body, are now a source of trade barriers, rather than the institutions of individual countries alone. As will be discussed later, European protectionism is evident in the agricultural industry.

In order to form an interregional market that functions, authoritative institutions must set rules and enforce them.[49] The European Union has the challenging task of providing leadership to its member states and applying fair and appropriate external trade policies. It is also the responsibility of the European Union to provide equal opportunities to companies and allow free trade. Without a well-functioning regulative system, companies with unique competitive positions could

[47] Ghemawat, 2001 pg. 138
[48] Ghemawat, 2001 pg.143
[49] Fligstein et al, 1996 pg. 1

abuse their position by creating a monopoly and forcing competitors out of the market. If this should occur, consumers and the market would suffer.

Regulations and laws for the European Union are set by different institutions in the Union regulatory body. Institutions function in three ways: *regulative*, *normative*, and *cognitive*.[50] The regulatory institutions are by far those most affected by European unification. From an economic perspective, regulative institutions set the law of how business is conducted in the market. The intention of European institutions is to break down the barriers of trade within the market but also provide protection to the citizens. A free regional market created opportunities for competition and market share growth. Because most companies conduct business with a self-interested motive, it is imperative to establish a system to regulate economic activities. According to institutional theory, the regulative perspective allows institutions to establish rules, scrutinize firms and act accordingly if rules are breached or not complied.[51] The established rules align with European's mission to create a more competitive market and protect the environment and citizens. The objective of this approach is to create an external control system in which companies should conform to institutional regulations to avoid penalties or sanctions.[52] Within the European Union, the European Commission enforces regulations and punishes companies if these regulations are not met. The European Union set high demanding

[50] Scott, 1995 pg.35
[51] Scott, 1995 pp. 35-36
[52] Scott, 1995 pg. 37

and strict regulations for the market to meet member states request of consumer and environmental protection.

Within the last decade, the European Union has been in court battles with multinational enterprises including several U.S. computer companies that did not abide by European regulations. The European Union accused these companies of violating Europe's anti-trust laws. For example, in 2004, Microsoft was penalized for abusing its competitive position by monopolizing Windows PC operating system.[53] The fine amounted to about half a billion dollars and it was the first time a company was assessed such a penalty.[54] It took Microsoft over three years to comply with European regulations. During this time, the company was hit with daily penalties. Currently, Intel, another U.S. computer company, is accused of monopoly abuse. The European Union charged Intel with "anticompetitor strategies" because they pressured European retailers not to sell competitor products, and bribed manufacturers to delay or cancel the production of competitor products.[55]

Europe took a strict position to force companies to conform to European regulations. The response to high penalties is to provide fair competition to companies in the market and to protect consumers, "…the measures that the Commission has insisted upon will benefit computer users by bringing competition and innovation back to the server market," explained European Union Competition Commissioner Neelie Kroes.[56]

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[53] CNN, 2004; Kroes, 2006
[54] European Commission, 2006a
[55] Associated Press, 2007
[56] European Commission, 2007b

The European Commission is also the regulatory apparatus of anti-trust issues and other trade policies within the European Union. Most merger and acquisition activities have to be approved by the Commission. The European Commission tends to grant or deny merger applications based on different reasons than the U.S. Department of Justice. The failed General Electrics-Honeywell merger, which was blocked by the European Commission, is an example of how regulatory ideologies differ in Europe from the U.S. "The GE-Honeywell merger was a classic example of the difference in antitrust theory on both sides of the Atlantic."[57]

In 2001 Jack Welch, former chairman of General Electrics (GE), sought approval by the Justice Department's Anti-Trust Division, for the GE-Honeywell merger. Both companies produced products for the airlines industries. Welch argued that the products were not overlapping. Instead, they are complementary, non-competitive, and therefore should not create an antitrust concern.[58] For the U.S. antitrust division, this distinction seemed sufficient to approve the merger. However, the European antitrust division, led by Italian economist Mario Monti, had a different view on this merger.[59] According to Monti, the difference in the size of the companies was the problem. "The Europeans were concerned with the bigness (size of company after the merger) itself – the fear that a company with overwhelming presence in certain markets would use its sheer power to drive out competitors, and then drive up prices for consumers."[60]

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[57] Vogel, 1997 pg. 102
[58] Reid, 2004 pp. 96, 97
[59] Elliott, 2001
[60] Vogel, 2004 pg. 102

3.3. European protectionism

Although integration was applauded from across the Atlantic, fear of excluding American products in Europe brought many American companies and politicians to the negotiation table with European regulators. The U.S. was concerned that eliminating the internal barrier within the European Union would create external tariff walls, thus creating a European fortress.[61] In other words, the European Union is a large open market but protects itself from non-member states goods and services. This claim of a European fortress existed prior to the creation of the European Union. However, the European Union repeatedly maintained an innocent stand to this claim.[62]

While the European Union's policies intended to strengthen internal trade and support certain industries, these policies indirectly created impediments to trade for U.S. companies.[63] In order for the European Union to be able to compete with other economic super powers, it had to apply a market strategy similar to the Japanese. This market strategy was based on internal freedom coupled with external protection.[64] Prior to the implementation of the European Union, Europe practiced three strategies that would protect the market from foreign companies. These strategies were: (a) anti-dumping actions; (b) reciprocal deals; and (c) informal quotas.[65] "Not only do anti-dumping actions introduce protectionism under cover of GATT rules, they are also flexible. The 'reasonable profit' clause allows the (European) Commission to hit

[61] Parker, 2006 pg. 6
[62] Lynn, 1992 pg. 29
[63] See case study in Part IV
[64] Lynn, 1992 pg. 29
[65] Lynn, 1992 pg. 29

almost anyone who is causing domestic manufacturers pain."[66] Since most of the anti-dumping actions happened in industries of European interest, foreign states argue that this is not a coincident but a protectionist strategy to keep competition out of the European Single Market.

European protectionism could also be the result of bilateral agreements between the European Union and foreign entities, with both parties having the same access to each market.[67] These discriminatory agreements give special trade perks to a specific region. Since this only favors parties of the agreement, it deviates from free trade theory whereby all companies should have equal access to each market. It also intentionally puts conditions on foreign companies and limits their entry into the market. Finally, in order to meet the European mission of protecting important industries, the European Commission entered into several informal agreements to meet the members' interests. Within the automobile industry, the European Commission agreed with Japan and limited automobile exports to Europe to 1.2 million cars per year by 1999.[68] Other examples of informal quotas are European subsidies to important European industries such as aerospace and energy.

With regards to trade agreements with non-member states, the enlargement of the Union presented many disadvantages for transatlantic relationships. The United States signed agreements titled Bilateral Investment Treaties (BIT) with Central and Eastern European countries. These treaties were incompatible with the European

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[66] Lynn, 1992 pg. 29
[67] Lynn, 1992 pg. 30
[68] Lynn, 1992 pg .30

Union policy; therefore, the European Union demanded that the treaties be annulled before these markets could join.[69] The United States had to revise their investment agreements with these countries so they would meet E.U. requirements.

Other accusations of protectionism are constructed by the European regulations body to protect European companies from foreign competition.[70] American critics of the European Union see the new Europe as a threat to American products. "The European Union is dangerous. It is a battleship Bismarck- blunting powerful American corporations, blocking sales of American beef, corn, and bananas, and plotting to demolish American leadership in world affairs."[71] Although this statement of European protectionism is overstated, it seems evident that overregulation and regulatory restrictions create barriers to transatlantic trade. It can be concluded that the European Union creates some constraints to international trade to protect local companies. "The range of protectionist measures used by the European Commission has the effect of a wall if not quiet a fortress around the Community."[72] Hence, European protectionism puts U.S. companies at a disadvantage.

[69] Baun, 2004 pg. 29
[70] Miniter, 2002 pg. 38
[71] Miniter, 2002 pg. 37
[72] Lynn, 1992 pg. 31

3.4. Differences in regulatory systems and stricter standards

Other critics argue that the European fortress is constructed by differences in stricter trade regulations, rather than protectionism. The arguments existed prior to the unification and even 15 years later, many U.S. companies were concerned about the European fortress. For example, a research study on transatlantic trade relations titled “Barriers of Benefits”, disagrees with critics of the trade liberalization’s views which argue that international competition will lower regional standards to gain a competitive advantage.[73] Instead, critics take the position that the European fortress is not a product of European protectionism, but rather cultural differences and a result of stricter regulatory policies. The European Commission focused its protection on the environment and consumers. Hence, European regulations are based on characteristics that provide protection for its citizens. Cultural differences existed long before European unification and, in fact, might have been somewhat reduced had a true ‘European identity’ taken hold. The influence of culture in policy-making is a major cause of transatlantic disputes. “Because both (US and EU) are affluent, open societies whose citizens place high value on consumer and environment protection, each is continually enacting new regulations and strengthening existing one.”[74] Implementing new policies and modifying existing one, echoes Lord Cockfield’s argument of an imperfect working market that is a work in progress and slows down the process of free trade.

[73] Vogel,1997 pg. 57
[74] Vogel,1997 pg. 1

Two key points are found throughout this literature which argues that the differences in regulatory system, not protectionism, are the main causes of trade conflicts. First, the difference in regulatory system, with the importance placed upon public values and culture, hinder efficient transatlantic business relations. "Many problems faced by EC or U.S. exporters/investors on each other's markets are not the deliberate result of protectionist inspired regulations, but rather the unintended outcome of measures adopted for valid domestic reasons of the differences which exist between the regulatory systems in the EC or US."[75]

The second key point is the European Union's implementation of stricter regulations to satisfy member states. The beef hormones ban in Europe ignited a dispute that began in the 1980s when children in Italy experienced illness after consuming veal treated with growth hormones. As a result, environmental groups spoke out against hormones treated meat and several European countries banned certain or all beef hormones. Some European countries allowed these hormones for their beef production. However, with the creation of the European Union and its harmonization and standardization policies, the European Commission banned all hormones in the entire single market to keep a commitment to the market. European public opinion was another factor of the ban, which consequently led to a disagreement with U.S. beef producers who used hormones in their beef production.[76] U.S. beef exporters denounced the ban, because of the lack of scientific evidence that any of the banned hormones presented a health risk to consumers. The hormone ban

[75] Vogel, 1997 pg. 12
[76] Vogel, 1997 pg. 16

was based on European cultural principles to protect consumer preferences with or without scientific proof and to comply with their demands.[77] The fact that the ban was based on consumer preference, gave the U.S. beef exporters enough to challenge the ban in front of the GATT and then the World Trade Organization.

Europe's response to these disputes reflected its ideology to trade regulation. French Minister of Foreign Affairs Edith Cresson explained, "This isn't a way to avoid the importation of meat; it's a matter of health."[78] Another comment made by a European Union representative was, "standards cannot and should not be solely based on science and that consumer preference should taken in account."[79]

Following several negotiations between the EU and international beef producers, the European Union loosened some of the bans and allowed certain beef hormones in the market. Although EU markets represented a small fraction of U.S. beef export, "the ban thus seemed to confirm America's worst fears about the emergence of Fortress Europe, that the liberalization of Europe's internal market would be accompanied by an increase in external trade barriers."[80]

Along with the beef exporters' ban, there were other trade constraints on U.S. exporters that involved health and safety issues. The European Union took a very strict position on genetically modified crops and restricted these crops in the European market. As a result, American agricultural exporters could not sell their genetically modified crops in the European markets, even though they had done so

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[77] Vogel, 1997 pg. 18
[78] Vogel, 1997 pg. 18
[79] Vogel, 1997 pg. 21
[80] Vogel, 1997 pg. 23

before. Agricultural companies such as Monsanto lost significant amounts in sales due to the genetic modified crops ban.[81] American companies did not only lose market shares in Europe, but the ban had a spill over effect to other regions such as Africa, that inevitably affected U.S. farmers.

Box 1. European regulation: The spill-over effect in Africa

European regulation: The spill-over effect in Africa

The constraints of strict regulation on genetically modified crops had a spill over effect to the African market and created problems to American's global market share. The European Union agreed to improve trade with African countries by removing all existing trade barriers between Europe and Africa. Using genetically modified crops would limit access to the European market by African farmers. Therefore, American providers of genetically modified crops had difficulties selling their bio-technology to African farmers.

Some African countries refused to accept food aid sent to regions plagued with famine because the food could be "contaminated" with genetically modified crops. Hence, to provide food aid to Africa, the U.S. could only buy from non-genetically modified farmers, or from abroad. The ban of genetically modified crops created disputes between the European Union and the United States. The U.S. accused Europe of impeding economic and humanitarian development in Africa.* For American companies that specialized in agriculture with genetically modified crops, the European single market became almost inaccessible. Agricultural exports had to be altered to meet European standards, which increased the cost of production.

*[82]

[81] Hayden, 2003
[82] European Union Press Release, 2007c

Regulatory differences on consumer and environmental safety also created constraints for American companies in Europe.

> “American cosmetics makers changed their formula for aftershave lotion because Brussels (Capitol of the European Union) passed a rule banning ethanol, an ingredient that was just fine with the U.S. government. McDonald’s changed the rubber toys placed in its Happy Meals all over the world because Brussels passed a rule banning a softening chemical that Mc Donald’s had used for years with no complaints from regulators in Washington D.C. The EU makes rules that govern Amazon.com’s sales techniques, and the bumpers that General Motors puts on its Corvettes, and the kind of wheat that General Mills can put in its Wheaties.”[83]

Although these examples had harsh effects American companies, these rules are established indiscriminately. The European Commission acts in the best interest of the people and enforces laws to support the European Union. European companies have to abide by the same regulations and fall under the same scrutiny as American companies, therefore, the argument that a Europe was acting as a “fortress’ should not apply in these cases.

[83] Vogel, 2004 pg. 232

3.5. Summary

These examples of constraints show that differences in approaches to health and safety issues between the European Union and the U.S. There were new and specific barriers for American companies in Europe, and the enlargement of the European Union became complex, thus making it difficult for American trade.[84] European Union advocates disagreed with the accusation of being a European fortress and responded by lobbying for the advantages the European Union would bring to non-member states. The question became what kind of bilateral trade agreements should be implemented to bridge the gap between the differences in regulatory ideology without jeopardizing the protection of consumer and the environment?

[84] Baun, 2004 pg. 36

PART IV

4.1. European Response

As illustrated in the previous sections, the creation of the European Union has increased internal free trade, but has not been able to achieve the same success from transatlantic trading partners. Trade disputes and trade flow data show that several impediments to trade to American companies still exist. These impediments result from non-tariff barriers for market protection and from different cultures, regulations and strict institutional controls. The European Union advocates lobby for taking the necessary steps to eliminate the existing barriers to trade. They argue that in order to free the European market from protectionist activities, transatlantic negotiation should focus on trade liberalization and market openness.[85]

The existing trade barriers have brought American and European representatives to the negotiation table to formulate trade agreements and facilitate commerce. An important issue in international trade is the interdependence between both markets. Germany's economic growth, for example, relies more on exports than on home consumption.[86] A slowing German economy would create a spillover effect and eventually hurt the American economy. Because the European market is connected with Germany, which is considered as the engine of European growth, a stagnant German economy would slow down overall economic growth in Europe. This, in turn would affect American exports to Europe and impede American

[85] Mandelson, 2005
[86] Miller, 2007

growth.[87] Therefore, it would be in both regions' self-interest to liberalize transatlantic trade flow. Good relations could be translated into increased trade flow and economic growth.

European representatives argue that the single market will create lucrative opportunities for American companies even with some existing constraints.[88] American complaints might have influenced the opening of the European market to non-member states, but an important reason was that "the internal market does not easily tolerate inconsistencies between internal and external measures."[89] To achieve internal and external free trade policies, a pro-transatlantic agenda based on free trade among both markets, played an important role in creating the European Union.

4.2. Theoretical framework: Free Trade

Economists and business individuals would agree that a firm's goal is to maximize profit. Generally, economic growth equals the increase of profit. Trade theory tells us that trade between markets that embrace free trade would allow companies to experience economic growth, thus increasing profit. Trade theory continues to elaborate that companies should specialize in production of goods and services that they can produce more efficiently.[90] A later revision of the theory argues that companies should specialize in regions where factor endowments are abundant. This school of thought introduced by Heckscher-Ohlin explains that by doing so,

[87] Peterson et al, 2003 pg. 35
[88] Jeelof, 1989; Spielmann, 1993; Baun, 2004
[89] Pelkmans, 1994 pg. 99
[90] Grosse et al, 1988 pg. 59

companies will create a comparative advantage, which eventually will lead to an increase of market share and consequently an increase in profit.[91]

Another feature of trade theory is the phenomenon of *economy of scale*, which occurs when a firm can reduce its cost associated with large output.[92] In addition, it lets companies use labor and equipment more productively to increase growth, which leads to more profit. Economy of scale allows companies to focus on production of a specific good or service and export to other regions in which trade agreements permit it. Companies would not only increase market share, but in certain instances, establish a first mover advantage, a strategic advantage that occur to the early entrants into an industry or market.[93] Accordingly, this also will create an advantage in increasing market share and profit. With regards to this theory, the characteristic of the European Union is an example of free trade. Hence U.S. companies that do business in the European Union can increase their market share.

In order to profit from free trade, markets have to liberalize trade and encourage the free flow of goods and services. If foreign products are hindered from entering the market due to tariffs, companies are prevented from creating a comparative advantage effectively. In the case of transatlantic trade, it is in the best interest of both to agree to trade liberalization and let free trade create economic growth for all trade partners. Benita Ferrero-Waldner, European Commission in charge of External Relations and European Neighborhood Policy, strongly pushed for good and healthy relationships

[91] Grosse et al, 1988 pp. 59-62
[92] Hill, 2004 pg. 182
[93] Hill, 2004 pg. 184

between the U.S. and Europe in order to keep a competitive position in the world market. She stated that to maintain close ties between the U.S. and Europe, both economies had to run on a transparent set of common rules.[94] The European Union promotes closer ties with the United States by entering into trade agreements and loosening trade regulations that have hindered US products to enter the market.

4.3. Transatlantic Trade: Approaches to closer ties

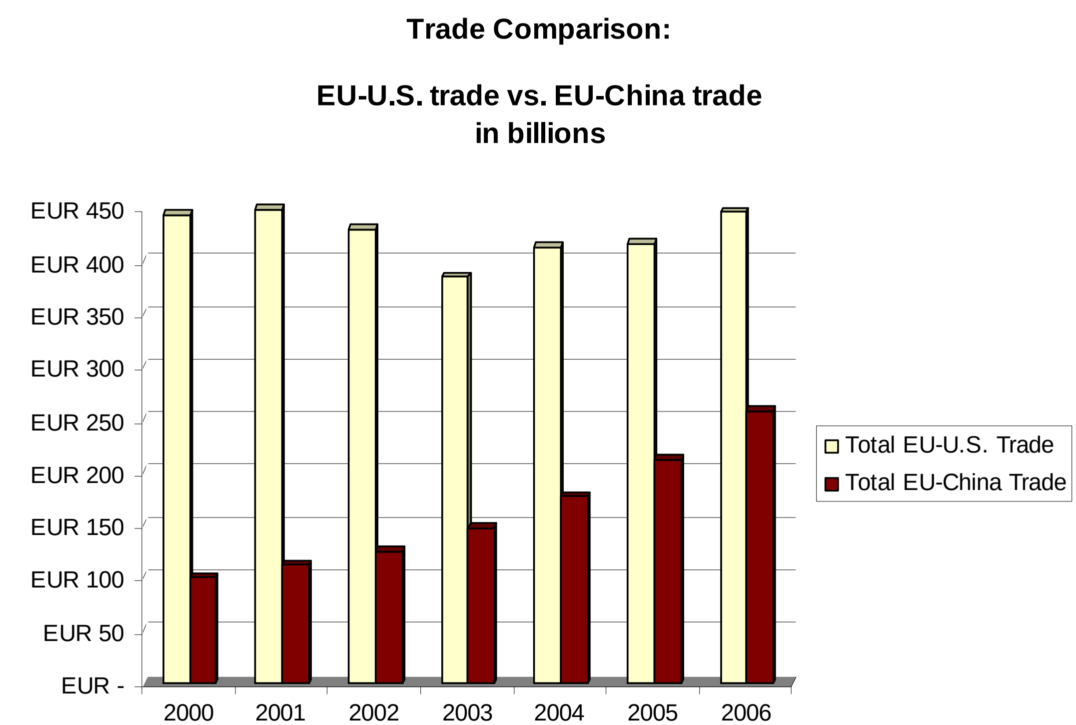
Transatlantic trade is the most abundant between the European Union and the U.S., as these regions have the largest bilateral relationship in the world.[95] Economic transactions between the two markets happen in three ways: (1) exports of goods and services, (2) foreign direct investment, and (3) trade between subsidiaries. Trade movement between both regions equals almost half of all world trades of good and services and the greater part of the trade flow is dispute free. About 14 million jobs are a direct result of transatlantic trade.[96]

Although, historically, the majority of trade was of goods, today foreign direct investment plays a significant role in international business. Almost half of American foreign direct investment went to Europe and in return, over two thirds of Europe's total world investment landed in the U.S. market.[97] "Trade- everything from farm products to automobiles to computer software- constitutes a relatively small portion of transatlantic economic activity, less than 20 percent. By a wide range, EU and U.S.

[94] Ferrero-Waldner, 2006 pg. 4
[95] European Commission, 2006
[96] Barroso, 2005
[97] Peterson et al, 2004 pg. 30-31

investment in each other economies is what drives markets jobs, innovation and business activities."[98] This results show clearly that both sides of the Atlantic have taken advantages of economic cooperation.

Chart 1: Total Trade (Import + Export) comparison. EU-U.S. vs. EU-China



Data Source: Eurostat: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=Yearlies_new_exttrade_eu27_by_product&root=Yearlies_new_exttrade_eu27_by_product/F7/tet00040

Bilateral trade agreements and economic summits are evidence that both sides of the Atlantic seeking closer ties between both markets. In 1995, the European Union and the United States agreed on a closer transatlantic partnership, titled the

[98] EU focus, 2007 pg.1

New Transatlantic Agenda. It is based on a four pillar action plan; promoting peace and stability, democracy and development around the world; responding to global changes; contributing to the expansion of world trade and closer economic relations; and building closer ties across the both regions.[99] The commitment to economic relations reads as follows:

> "We will strengthen regulatory cooperation, in particular by encouraging regulatory agencies to give a high priority to cooperation with their respective transatlantic counterparts, so as to address technical and non-tariff barriers to trade resulting from divergent regulatory processes. We aim to conclude an agreement on mutual recognition of conformity assessment (which includes certification and testing procedures) for certain sectors as soon as possible. We will continue the ongoing work in several sectors and identify others for further work."[100]

Over the last decade, American and European trade representatives have set up transatlantic institutions to establish a regulatory body that hopes to eliminate the still existing barriers to trade. The advantages of transatlantic institutions are that it would lobby for the best interest for both markets indiscriminately. The intention to create transatlantic institutions was to *deepen* transatlantic trade by opening the economies. The European Air Safety Agency set new objectives to improve air transport within the European Union and its neighbor states. In addition, it works on creating a single airspace between Europe and the United States, with the hopes to increase economic growth. Jacque Barrot, European Commission Vice President, states that "an open aviation area would generate some 17 million extra passengers a year and consumer

[99] Curtin, 1998 pg. 2
[100] European Commission, 1995

benefits of over 5 billion dollars a year, not to mention new jobs on both sides of the Atlantic."[101] An agreement was signed in April 2007 with the intention to create a single air transport market between Europe and the United States.[102] Within that new market American and European airlines have access to each market and will make travel and transport between both markets easier. In addition, this agreement will bring Europe and the USA closer together and will have a positive economic impact on both markets. Jacques Barrot saluted the cooperation between Europe and the USA and its effect on Europe. "Already, the European airline industry is feeling its effects in a positive way, with plans for new services and signs of a much more flexible and dynamic approach to airline investment among European carriers."[103]

Trade between the United States and Europe is characterized mainly by *harmonization agreements*. Especially in the pharmaceutical industry, drug approval between Europe and the USA are harmonized.[104] Harmonization is defined as a process where regulations are changed so that they meet the requirement of an international institution which set international standards.[105] However, this process of trade liberalization through harmonization is difficult to achieve, because it implies that a country changes its regulatory system to meet the standards of the trading partner. Currently, there are talks to create more *Multinational Recognition Agreements* between the U.S. and Europe.

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[101] Barrot, 2005
[102] European Union Press Release, 2007d
[103] European Union Press Release, 2007d
[104] Vogel, 1998 pg. 1
[105] Courville et al, 2004 pp.3-4

The concession of Mutual Recognition Agreements, a process that exists among the European member states or a combination of both (harmonization and mutual recognition) could create an even more effective trade system.[106] Mutual Recognition Agreements are characterized as a process by which regulatory institutions develop confidence that the reports or certificates of foreign institution have the same value.[107] In short, the regulatory institutions from a particular region recognize products and services that have been accepted by a regulatory institution in a foreign region. These agreements require a high level of trust in foreign regulatory procedures and the benefits are high for companies, because they don't have to adopt their products to different regulations and only have on fulfill one testing requirement.

With both regions understanding the importance of market openness and liberalized trade, trade disputes should weaken over the time. To explain the characteristics of transatlantic disputes, Mariann F. Boel, European Union Agriculture and Rural Development Commissioner, describes it as "two elephants making a lot of noise" and "we seem to speak different but similar dialects of a strange technical languages."[108] Both regions find it difficult to agree on a trade agreement that would benefit both sides equally. However, there have been several steps to reform the economic policies.

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[106] Courville et al, 2004 pp.3-4
[107] Courville et al, 2004 pg.5
[108] Boel, 2005

4.3.1. Case Study: Common Agricultural Policy - The Reform

Box 2: Treaty of Rome: Article 39

The Objectives of the Common Agricultural Policy
Treaty of Rome: Article 39

- Increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labor;
- Ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
- Stabilize markets;
- Assure the availability of supplies;
- Ensure that supplies reach consumers at reasonable prices.

Sources: European Commission
http://www.bmdf.co.uk/rometreaty.pdf

History- In the mid 1960s, a significant amount of Europe's employment was in the agriculture sector. It was important to the Union to set up policies to support farmers in Europe. The Common Agriculture Policy's objective, employed in 1962 was to stabilize European agriculture market by increasing agricultural productivity, ensuring supply-chain and competitive prices, and guaranteeing a fair standard of living for farmers.[109] This policy guaranteed minimum prices on certain crops. In addition, it discriminated against foreign goods through tariffs and import prices.

Even if U.S. products entered the market, there were more hurdles to jump over to compete for the European market share. The Common Agricultural Policy had a clause that demanded European member states import agricultural products from

[109] Oudenaren, 2000 pg. 131

other member states first, before allowing goods to enter from abroad.[110] This practice created trade diversions that would discriminate against foreign suppliers and affect competition negatively. To make things worse, the European Union set “entry prices” on foreign goods entering the market, which were normally higher than the market price; hence U.S. products had difficulties competing in the market. This approach was a tool of protectionism to keep competition out of the market.

While trade diversion and universal prices in Europe allowed European farmers to increase market share, they decreased farmers’ competitiveness in the world market. The Common Agricultural Policy awarded European farmer with subsidies to compensate for the loss in the world market.[111] The lack of competitive prices and government subsidies not only affected foreign goods in the European market, but it also manipulated world prices. The Common Agricultural Policy created many disputes between to the U.S. farmer supporters and the European Union, because of the inaccessibility to the European market. Mariann Fischer Boel, Agriculture and Rural Development Commissioner, defended the creation of the Common Agricultural Policy as follows: “In much of Europe, food shortages had become serious, and damaged national agricultural systems needed to rebuild themselves. The alternative was hunger, social disorder in rural areas and an exodus from farmland to cities which were already short of housing and jobs.”[112]

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[110] Oudenaren, 2000 pg. 131
[111] Oudenaren, 2000 pg. 132
[112] Boel, 2005

The European Union seemed to understand the implication of the Common Agricultural Policy on trade relations and world prices. Therefore, they revised the policy to make the European agricultural industry more competitive and to diminish trade disputes with the United States.

Policy reform- Following heated trade disputes with the U.S., the European Union decided to cut guaranteed prices on farm goods. In addition, the new reform reduced tariffs on foreign goods. European farmers have to follow and maintain strict environmental rules to be rewarded financial support from the government. Instead of offering free money as subsidies, this money will be used to provide "- pleasant fields, clean air and water, a reliable level of food safety" to European citizens.[113] As a result, farmers focused their production on demand driven goods and competition against foreign exporters. With these reforms, Europe is opening up the market to competition and keeping its commitment to social protection. "Our priorities should therefore to be to invest massively more in the future and at the same time help workers to adapt to the more rapid economic changes that the combination of deeper market integration and increased supply side investment will bring."[114]

The Common Agricultural Policy presents a good case study of how the European Union is modifying regulations to open up the market to foreign products. The question on existing disputes such as genetically modified crops has not been answered yet. Since this dispute reflects different ideologies of consumer and environmental safety, it is doomed to continue to stay on the top of transatlantic

[113] Boel, 2005
[114] Mandelson, 2005

negotiation agendas. However, it is predicted to find concessions instead of a trade war.[115] In an address at the Doha Round, Mariann Fischer presents Europe's position on genetically modified crops: "If the EU agreed to open up its agricultural markets that include genetically modified (GM) products. We have no anti-GM agenda. And we are not trying to smuggle in protectionism through the back door, under cover of concerns about food safety and the environment."[116] In 2001, the European Commission approved genetically modified processed oil for food use. Six years later, the European Commission authorized several genetically modified oilseed rapes to be sold in the European market if they meet safety and appropriate labeling standards.[117]

4.4. Effects of EU external relations

Although the enlargement of the European Single Market creates some challenges to U.S. economic and political interests, it also has a positive effect as well.[118] The European Union not only created a larger playground for international companies, but also established a more stable and predictable macro-economic climate for investments, with uniform rules.[119] Most importantly, the enlargement of the European Union ended the discrimination of American products in European countries that were not part of the European Union. The European Union signed bilateral treaties with several central and eastern European countries, which allowed

[115] Pollack et al, 2000 pg. 53
[116] Boel, 2005
[117] European Union Press Release, 2007a
[118] Baun, 2004 pg. 28
[119] Baun, 2004 pg. 28

European goods and services to enter the markets without barriers but required American companies to pay high tariffs. Due to this, American goods and services had to compete against European Union's duty-free products in eastern and central European markets.[120] With the enlargements of the European Union, eastern and central European markets fall under the same policy of the European Union and therefore, American products became more competitive in eastern and central European market, because tariffs (if applicable) might be lower in the European Union. Trade agreements with the European Union had a tendency to be more beneficial than with eastern and central European countries.

American companies have varies interests in conducting business in Europe. There are companies that export to Europe without significant physical presence in the market and there are companies that have a presence through subsidiaries or joint venture.[121] Foreign companies with a significant European market presence increased their investments dramatically.[122] Even companies that recently entered the markets took advantages of European grant programs. The telecommunications industry benefited greatly from European grants. IBM, AT&T and DEC participated in grant programs from the European Union. To take full advantage of the expanded single market, companies should establish themselves in the market. "When you see the profits being made by companies like Ford and General Motors in the European operations, you know that they have established themselves in the European

[120] Baun, 2004 pg. 28
[121] Spielmann 1993 pg. 31
[122] Jeelof, 1989 pg. 412

operations, and have done that in a very profitable way."[123] A stronger European market will benefit American companies.

If the extension of the European single market created more opportunity for U.S. companies, would the fear of a European fortress still occur? History has showed that this fear is unjustified. As long as the European single market was an open market and sought international trade relationships with the United States, both sides would benefit from this relationship. In 1989, Gerrit Jeelof, Vice Chairman of N.V. Philips Corporation, presented a lecture at the University of Michigan promoting transatlantic trade and addressing the accusation of a "European Fortress". He argues that it would be an outcome of American attitude towards European companies. If the U.S. discriminated against the establishment of European companies in the U.S., then it would be reasonable that Europeans would create similar discriminatory practices against U.S. companies.[124] In other words, a European Fortress in form of trade barriers would retaliate against US restrictions on European trade.

4.5. Summary

European approaches to ease transatlantic tensions present a promising future for American companies. With the right international strategy to penetrate the European Single Market, U.S. companies could increase profit from European trade attitude. In other words, when overcoming obstacles that have been created through differences in regulations, Europe offers opportunities for abundant profit.

[123] Jeelof, 1989 pg. 416
[124] Jeelof, 1989 pg. 415

PART V

5.1. Opportunities in the European Union

There are various circumstances that present advantages of the European Union to American companies. First, established American companies in the European market should enjoy the same perks of regional integration as European companies. Some of these perks are free flow of goods, services, labor and investment within the market, which reduces transaction and transportation costs. Liberalized trade and competition allows companies to compete for market share and make them more efficient Second, by adapting to European regulations, new opportunities arise. The characteristics of the European market reduce the distance between both markets. Taking into consideration the cost of distance versus benefits, it can be argued that the opportunities will outweigh constraints on U.S. companies. Advantages will arise from taking advantages of opportunities by applying strategies of arbitrage. *Arbitrage* in this context means to benefit of cultural, economical and administrative differences.[125] It can be concluded, that because the European member states accept uniform regulations, and administrative procedures, US firms can benefit by using a localization strategy to comply with European regulations. This will achieve economies of scale approach (with limited modification to meet differences in demand) because the products do not have to comply with other

[125] Ghemawat, 2003 pg. 3

regulations. Regional integrated markets can reduce liability of foreignness to non-member firms.

5.1.1. Distance opportunities

As discussed previously, the distance between Europe and the United States has changed and it has resulted in creating benefits as well as constraints for American companies. Geographic distance could be assessed as a shorter distance. For instance, in order for an American product to reach a particular European member state market, the product has to travel the physical distance through other countries that are located between both states. Prior the creation of the European Union, border control and customs slowed down transportation. Since creation of the European Union, the American product has a closer port of entry to the market and does not lose time at each border.

The European Union possesses one of the most advanced transportation systems in the world, which facilitate intra-European transportation. The transportation network is interconnected with European states and its neighbors. In addition, European institutions were able to reduce distance between Europe and the United States by creating a transatlantic aviation area. Considering the advancement of infrastructure, the new size of the European market, and the elimination of borders in Europe, it can be concluded that the European Union reduces distance between both markets, hence reduced transportation costs.

5.1.2. Economic & Administrative Opportunities

One of the key complaints from American companies regard stricter European regulations and standards. American firms have had to adjust many products to meet European standards, which has increased production costs. However, complying with the standards can be an advantage as well. Many competitors might not be able to meet the strict regulations set by the European Union. The cost to enter the market, would allow only certain products to compete in the market. As a result, only few and very competitive products would compete for market share. This would not only apply to non-European products but to some European products as well. Prior to the implementation of the single market policies, several European countries had more relaxed policy on products, which means they had to adopt to the new standards as well.

By adopting products to higher consumer and environmental protection, American firms could create a competitive advantage by offering consumer and environmental friendly products. This would not only create entry in the European market but might be beneficial in the home and world market as well. Since European standards are very strict they might meet standards in other regions as well. Consequently, products could be standardized to European standards and sold internationally, thus creating an economy of scale.

European economic reforms create opportunities for arbitrage. The elimination of physical barriers allows American companies to find the most efficient place and strategy to conduct business, where the liability of foreignness is low. From there, products can be shipped to different market segments of the European Union. The United Kingdom might be a good place of entry into the European Union with respect to the liability of foreignness because of many similarities, such as English being the defacto language of business.

Then there is arbitrage of factor endowments, labor, and knowledge. Companies can set up business where factor endowments are abundant and inexpensive to obtain. The new accession of Eastern Europe could present a good place for investing in factor endowments. These countries have not been part of the European Monetary Union yet, thus still using their national currency. These currencies might stand weaker against the dollar than the Euro, which means investment could create better value. From a long term perspective, land and currency may increase in value (assuming they will convert to Euro in the near future) and the return of investment will pay off.

For multinational companies, it is important to recruit a talented workforce. The European Union has a variety of diverse human capital with varied educational and professional backgrounds. American companies can pull talented labor from across Europe to take advantage of differential knowledge. The elimination of physical barriers combined with the free flow of labor makes it possible to relocate labor within the European boundaries. The flow of labor and transfer of knowledge contributes to creating comparative advantages to multinational companies.

The strong Euro also presents further opportunities to American products. Since the Euro has been very stable and strong against the U.S. dollar, American exports to Europe should increase, because American products are cheaper with respect to the value of currency. The strong currency also has an effect on profit. If the profit margin in Europe is the same as it is in the United States, American companies will experience a higher profit than in the home region. The stable Euro encourages foreign direct investment in Europe. But most importantly, conducting business in Europe does not imply dealing with 27 different currencies. The single transparent currency also allows companies to conduct arbitrage. US firms can shop within the entire market to find the best price for a particular product or decide to buy from outside the European boundaries. This would encourage prices to become more competitive.

European economic reform required government to liberalize industries and surrender partial or full control over state owned enterprises. Over the years, state owned enterprises have held monopolistic position in industries such as telecommunication, energy, and transportation. Trade liberalization would end this. What does trade liberalization in protected industries mean to American companies? These former state owned companies have the majority of market share and an advantage because of brand awareness. However, due to the long-time monopolistic position, competition is non-existent or very limited. As a result, American companies that penetrate former protected industries can create an early mover advantage; being one of the first competitors in the market. In addition, American companies might have more experience doing business in a competitive environment, whereas state-owned enterprises find it more difficult to implement strategies that deal with competition. With innovative strategies, American companies can take advantage of the economic changes and opportunities in Europe.

5.1.3. Cultural opportunities

From a cultural perspective, the European Union has become more diverse and international, due to the easier movement of people in the Union. The free flow of people within the Union allows European citizens to become more aware of the differences and united culturally as well. The single currency is an example of a common culture. People deal with money on a daily basis. The money represents sovereignty and an identity. The single currency connects member states' culture and creates a European culture or identity that did not exist before. In the future, with deeper integration, the gap between countries' identities could shrink and a European focused identity or cultures could be the outcome, which is describes by T.R. Reid as "generation E".[126] Dealing with fewer cultural differences create opportunities to multinational firms. Companies can focus on cultural similarities and modify products where preferences or taste of the target groups differ.

The new European generation has the opportunity to travel and relocate easier within the Union. They are more aware of the European cultures and languages. A population that takes advantages of economic changes in culture creates new opportunity for business. For example, Germans can now commute more freely and cheaply to Portugal, thus increasing the demand for transportation. American

[126] Reid, 2004 pp. 197-227

automobile manufactures have designed cars for the European market that travel long distances and through different geographic areas.

Even with the benefits of tolerance, proliferation and a mixture of European cultures, there is no evidence of one widely accepted European culture or identity. The European unification has lowered most barriers of regulatory institutions, and yet the cognitive and normative institutions, which include culture, have not greatly diminished. However, these differences can be exploit as well. The differences can be the source of a firm-specific competitive advantage. As argued in international business literature, companies who are good at assessing and responding to demands for local responsiveness will flourish where other companies falter.

PART VI

The main lesson of the study is that there are two broad sources of opportunities to U.S. firms in the European Union. While external regulatory barriers still exist, European institutions have attempted to lower these barriers to encourage transatlantic trade. Once these barriers are breached by U.S. firms, they will flourish from the opportunities the expanded market brings. The second source of opportunities derives from country-specific barriers, including cultural differences. The European Union may reduce cultural barriers some day. Since these cultural differences still exist, U.S. firms that excel at local responsiveness will enjoy a competitive advantage.[127]

6.1. Limitations

There are several limitations that make it difficult to fully understand the effects of the European Union on US business. First, the European Commission is integrating and updating policies which influence international trade. This makes it difficult to forecast trade opportunities in the near future, although bilateral trade agreements and policy reform show a tendency of increasing opportunities for American companies. Second, the European Union is still in its beginning stages. With only 15 years of existence, it is it difficult to predict long-term effects based on past experiences. Third, Europe is expanding, adding more members to the Union. By

[127] Bartlett & Ghoshal, 1998

doing so, more countries fall under European economic procedures and this may impact US business with these new member states. For example, Turkey has several bilateral trade agreements with the United States. US companies export to Turkey. If Turkey is granted membership to the European Union, the bilateral trade agreements between the United States and Turkey might change, which could create advantages or constraints for U.S. firms. Finally, the advancement of technology, such as cheaper and better telecommunication, transport and information technology will create new business opportunities in these areas.

6.2. Future Work

The European Union is the most integrated market from all regional trading regions in the world. However, it is still evolving. The deepening and widening of the market affect trade relations as well. From firm level perspectives, future studies might examine what attributes American companies need to possess to take full advantages for the market. Continued studies in academia could analyze if the economic characteristics of the European Union can be applied to other economic regions with similar of different characteristics.

6.3. Conclusion

The creation of the European Union was inevitable amid world economic changes in the 1980s and 1990s. European institutions have to implement a market system that encourages intra-regional trade but also shows integrity to European consumers and environmental protection values. Strict regulations force many multinational companies to change production procedures and strategies, which increase total production costs. The protection of major industries creates further barriers for some American goods and services. However, the European Union understands the importance of good transatlantic relations and is working on eliminating barriers. Europe's attitude is reflected in bilateral trade agreements and economic reforms that open up the market for American products.

Even with existing non-tariff barriers, the characteristic of the single market allow U.S. companies to benefit. Because the European Union is one gigantic market that encompasses 27 individual markets, U.S. firms face a reduced liability of foreignness. The distance between culture, business procedures still exist, but the creation of European Union gives some commonalities and leverage, which reduces distance.

When an American company meets the necessary requirements to enter one the European member states, the liability of foreignness is reduced due the elimination of intraregional barriers and the reduction of distance. Once established in one European market, achieving economies of scales, improvement of knowledge transfer and the expansion to other European market should be easier than prior to the creation of the European Union. As a result, it can be concluded that the European Union presents lucrative opportunities to American companies.

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